CSR and Negative Corporate Events: The Moderating Role of Managerial Overconfidence

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Synopsis

The research problem

The first objective of this paper is to investigate whether and to what extent the level of managerial overconfidence plays a role in affecting firms' post-restatement CSR engagement. The second objective is to investigate whether and how managerial overconfidence affects the post-restatement association between CSR engagement and firm value.

Motivation

Although research suggests that CEO characteristics are key determinants of firms' CSR engagement/performance, it remains unclear whether and how CSR engagement as a corporate response to financial restatements relates to managerial overconfidence. It is also unclear about the role of overconfident CEOs in explaining the heterogeneity between firms' CSR engagement and firm value for firms with financial restatements.

The test hypotheses

Our first hypothesis considered whether and how the association between CSR and financial restatements varies with CEO overconfidence sheds light on the capital market implications of CEO overconfidence for firms that experience value-destroying events. Our second hypothesis tested how overconfident CEOs respond to concerns about reputational loss following major corporate negative events.

Target population

We focused on the publicly held U.S. companies with a focus of the firms having a serious financial restatement.

Adopted methodology

We utilize a matched sample of firms having a serious financial restatement. We perform regression analyses and a set of robustness tests.

Analyses

Using the publicly held U.S. company data for the period 2001–2018, we examined the impact of CEO overconfidence on CSR around the serious financial restatements. The data for regression analyses were obtained from COMPUSTAT database, KLD database, Execucomp database, and Violation Tracker database. We compare the changes in CSR and firm value around the financial restatements.

Findings

We found that relative to restating firms with non-overconfident CEOs, restating firms with overconfident CEOs tend to underestimate potential reputation loss from their financial restatements, and also underestimate the role of CSR in repairing their post-restatement reputation loss, which in turn lead firms to exhibit a lower level of post-restatement CSR engagement. Additional results suggest that the presence of an overconfident CEO weakens the relationship between CSR engagement and firm value of restating firms. Overall, our findings suggest that CEO overconfidence can play a significant role in determining the level of restating firms' CSR engagement and moderating the relationship between CSR engagement and firm value of restating firms.

Keywords: corporate social responsibility; overconfidence; restatements; firm value

JEL Classification: M40.